



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced	02/20/02	Bill No:	AB 2205
Tax:	Cigarette and Tobacco Products	Author:	Koretz
Board Position:		Related Bills:	

BILL SUMMARY

Among other things, this bill would increase the penalty for possessing, selling, or offering for sale unstamped cigarettes from one hundred dollars (\$100) to two hundred dollars (\$200) for each carton of 200 cigarettes.

ANALYSIS

Current Law

Section 30474 of the Revenue and Taxation Code provides that any person who knowingly possesses, keeps, stores, or retains for the purpose of sale, or sells or offers to sell, any unstamped package of cigarettes is guilty of a misdemeanor punishable by a fine of not more than one-thousand dollars (\$1,000), imprisonment for not more than one year in a county jail, or both. The guilty person must also pay one hundred dollars (\$100) for each carton of 200 cigarettes possessed, sold or offered for sale, as determined by the court. The court must direct that 50 percent of the penalty assessed be transmitted to the local prosecuting jurisdiction, to be allocated for costs of prosecution, and 50 percent of the penalty assessed be transmitted to the State Board of Equalization (Board).

Proposed Law

This bill would, for the period beginning on January 1, 2003, and ending on January 1, 2006, increase the penalty for possessing, selling or offering to sell unstamped cigarettes from one hundred dollars (\$100) to two hundred dollars (\$200) for each carton of 200 cigarettes. The court would direct 50 percent of the first one hundred dollars (\$100) to the local prosecuting jurisdiction and 50 percent to the Board. The second one hundred dollars (\$100) would be directed by the court to the Controller for deposit in the Unlawful Sales Reduction Fund, which this bill would create. Upon appropriation by the Legislature, the moneys in the fund would be allocated to the Board for the funding of a competitive grant program.

The competitive grant program would enable grantee cities to establish a multi-agency task force, the composition of which would include prosecutors and local law enforcement personnel, for the purpose of significantly reducing the sales of black market cigarettes, and creating a deterrent to those sales through the focused

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investigation and prosecution of sales of black market cigarettes and other associated offenses and related crimes. This bill would allow no more than 5 percent of the amount transmitted from the second one hundred dollars (\$100) of the penalty assessed to be retained by the Board to fund costs of administering the competitive grant program.

This bill states legislative findings that the sale of black market, untaxed cigarettes has resulted in losses to the state of hundreds of thousands of dollars in revenue, robbing the state healthcare and programs designed to help children.

This bill also states it is the intent of the Legislature to provide resources to prosecutors and local law enforcement personnel, and to enable cities to develop a multi-agency task force, for the purpose of significantly reducing the sales of black market cigarettes and creating a deterrent to those sales through the focused investigation and prosecution of sales of black market cigarettes, and other associated offenses and related crimes.

Background

In 1959, Assembly Bill 1172 (Chapter 1040) added Section 30474 to the Revenue and Taxation Code. In 1983, Assembly Bill 1485 (Ch. 1092) increased the amount of the penalty to be paid by a person guilty of possessing, selling or offering to sell unstamped cigarettes, from twenty-five dollars (\$25) to fifty dollars (\$50) for each carton of 200 cigarettes.

In 1993, Senate Bill 704 (Chapter 1113) increased the penalty to one hundred dollars (\$100) for each carton of 200 cigarettes. That bill also provided that the court shall direct 50 percent of the penalty assessed to the local prosecuting jurisdiction, to be allocated for costs of prosecution, and 50 percent to the Board.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Los Angeles City Attorney and is intended to reduce the availability of cigarettes on the black market, to restrict youth access to cigarettes, and to eliminate burglaries, vandalism and other street crime associated with black market cigarette sales.

According to the sponsor, the negative societal consequences of black market cigarette sales are staggering. Young people are the most likely to purchase black market cigarettes. Street vendors of illegal products sell in areas that are populated by young people, such as parks, video arcades and donut shops. They often sell near schools and in residential areas. Often, individual cigarettes are sold to minors. The younger a person begins to smoke, the more addicted they become. In addition, law enforcement notes a correlation between gang-related activity and black market cigarettes. Street gangs play a prominent role in the contraband tobacco market, particularly those that run cigarettes from Mexico to Los Angeles.

Although local law enforcement, such as the Los Angeles Police Department, recognizes the increase in the black market cigarette cases, their resources are often diverted to other priorities and they are unable to address this growing

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problem. This bill is intended to provide the needed resources to local law enforcement to reduce the availability of cigarettes on the black market, to restrict youth access to cigarettes, and to eliminate burglaries, vandalism and other street crime associated with black market cigarette sales.

2. **This bill would require the Board to administer a competitive grant program.** The Board's current responsibilities include, in part, the administration of the state's sales and use tax, fuel taxes, alcoholic beverage tax, cigarette and tobacco tax, and other excise taxes, and the collection of fees that fund specific state programs. The responsibility of administering a grant program would be a new role for the Board. The sponsor of this measure believes that this new responsibility would strengthen the relationship between the Board and local governments with respect to cigarette tax enforcement.
3. **Would this measure produce enough revenues for a grant program?** Under current law, each person convicted of possessing, selling or offering to sell unstamped cigarettes shall pay one hundred dollars (\$100) for each carton of 200 cigarettes. To date, only a very small fraction of seizures have resulted in penalty assessments. According to the Board's Investigations Division, the courts have assessed \$231,081 in penalties in the last six years. These penalties were all assessed in cases involving the prosecution of felony offenses. Felony offenses typically involve the administrative seizure of hundreds of cartons of cigarettes, which would involve penalties in the millions of dollars if assessed at one hundred dollars (\$100) per carton of 200 cigarettes. Because the penalty would be extreme relative to the tax if assessed at the maximum amount, the courts typically decrease the amount of the penalty.

The penalty for selling unstamped cigarettes also applies to misdemeanor offenses. However, Board investigators do not have the statutory authority to issue misdemeanor citations. While local law enforcement does have the authority to issue misdemeanor citations, they do not have the resources to address the growing problem of cigarette tax evasion. This measure is intended to provide the necessary funding to local law enforcement to develop a multi-agency task force for the purpose of significantly cracking down on cigarette tax evasion. It is the sponsor's belief that most of this funding would come from the issuance of misdemeanor citations by local law enforcement.

4. **This measure does not contain provisions to continue the grant program for monies remaining in the Unlawful Sales Reduction Fund after the January 1, 2006 repeal date.** Such provisions should be included in this bill so the Board could continue to fund grants until monies in the Unlawful Sales Reduction Fund are depleted. Board staff is willing to work with the author's office in drafting appropriate amendments.

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5. **Suggested technical amendments.** To accomplish the author's intent, the following clarifying amendments are suggested:

30474. (d). Any person who knowingly possesses...in violation of this section, as determined by the court. The court shall direct ~~that 50 percent~~ of the first one hundred dollars (\$100) of the penalty assessed that fifty dollars (\$50) be transmitted to the local prosecuting jurisdiction, to be allocated for costs of prosecution, and ~~50 percent of the penalty assessed~~ fifty dollars (\$50) be transmitted to the State Board of Equalization.

COST ESTIMATE

The Board would incur non-absorbable costs to adequately develop and administer a competitive grant program. These costs would include notifying potential grantees, developing an application package, programming computers, and mailing and processing grant applications. A cost estimate of this workload is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

Current law allows judges to impose a penalty of \$100 per carton on sellers of unstamped cigarettes. Board data indicate that an average of 17,000 cartons of cigarettes were administratively seized per year for a recent six-year period. Board investigators do not have statutory authority to issue misdemeanor citations as envisioned by AB 2205. Therefore, under current law, only a very small fraction of seizures have resulted in penalty assessments. Board Investigations Division staff data indicate that assessments obtained in Superior Court have averaged approximately \$40,000 per year over a period of six years. These are cases that were prosecuted for felony tax evasion. At \$100 per carton, this would be approximately 400 cartons per year, or about 2 percent of total cartons seized. At \$200 per carton, penalty assessments obtained through felony prosecutions would be about \$80,000 if there were no increase in the number of cartons assessed.

There is a great deal of uncertainty as to how many additional seized cartons would be assessed under the provisions of this bill. However, it is likely that assessments will increase considerably. Discussions with Board staff indicate that a reasonable assumption would be that 50 percent of cartons seized would be assessed the penalty from misdemeanor citations issued by local law enforcement and handled at the municipal court level. Under this assumption, penalty assessments would be approximately \$1.7 million (17,000 cartons x 0.50 x \$200 = \$1,700,000.) This is approximately \$1.6 million more than what the current number of assessed cartons would indicate (1,700,000 – 80,000 = \$1,620,000).

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Revenue Summary

Under the provisions of this bill, penalty assessments would increase by approximately \$1.6 million.

Qualifying Comment

We have no information on actual collections of the \$40,000 in current-law penalty assessments. Projecting actual collections of increased assessments would be even more tenuous.

Analysis prepared by:	Cindy Wilson	445-6036	03/15/02
Revenue estimate by:	Joe Fitz	323-3802	
Contact:	Margaret S. Shedd	322-2376	

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